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OPINIONS BELOW

The opinion of the District Court in *United States* v. *Hine Pontiac* (*Hine Pontiac*, R. 85–86) is not officially reported. The opinion of the District Court in *United States* v. *Modern Olds, Inc.* (*Modern Olds*, R. 63–65) is not officially reported. The findings of fact and opinion of the Tax Court in *Commissioner* v. *Kilborn* (*Kilborn*, R. 24–25) are reported at 29 T. C. 102. The Court of Appeals did not write an opinion in any of the three cases.[2]

JURISDICTION

The judgment of the Court of Appeals in *United States* v. *Hine Pontiac* was entered on September 6, 1958 (Appendix A, *infra*, pp. 9–10); its judgment in *United States* v. *Modern Olds, Inc.* was entered on September 15, 1958 (Appendix A, *infra*, pp. 11–12); and its judgment in *Commissioner* v. *Kilborn* was entered on September 30, 1958 (Appendix A, *infra*, pp. 13–14). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether an accrual-basis taxpayer who sells property and receives part of his gain on the sale in cash and part in the form of a credit—the latter portion to be ultimately satisfied either by payment in cash or by offset against the taxpayer's obligations—is required to report the amount of gain so credited

[2] In all three cases, pursuant to stipulations, judgments were entered by the court below in conformity with its decisions in *Texas Trailercoach, Inc.* v. *Commissioner*, 251 F. 2d 395, and *West Pontiac, Inc.* v. *Commissioner*, 257 F. 2d 810.

as well as the gain in cash) as income for the year in which the credit is made.[3]

STATUTES AND REGULATION INVOLVED

The statutory provisions involved are Sections 22 (a), 41 and 42 of the Internal Revenue Code of 1939. Those sections, together with Rev. Rul. 57–2, 1957–1 Cum. Bull. 17, are set forth in Appendix B, *infra*, pp. 15–19.

STATEMENT

Hine Pontiac:

During the taxable years 1953 and 1954, Hine Pontiac, an accrual-basis taxpayer, was engaged in the business of selling new and used automobiles. It sold cars on credit, with a bank or finance company agreeing to accept the note of the purchaser for the unpaid balance of the purchase price plus finance charges. Under a separate contract between the dealer and the finance company, the notes were accepted, without recourse, and the finance company remitted to the taxpayer the unpaid portion of the selling price of the automobile. (*Hine Pontiac*, R. 26, Exs. 3–6, R. 29, 31–58.)

Under the agreement between taxpayer and the finance company, the notes were acquired by the finance company at a specified rate of discount. To the extent that the interest and finance or service charges included in the notes exceeded the specified rate of discount in the contract, the finance company recorded a credit to a so-called dealer's reserve account,

[3] Other issues raised by the pleadings were not reached by the courts below.

the credit being made immediately upon the assignment of the note. Any losses sustained by the finance company arising from the failure of the security to be sufficient to satisfy the balance due on the note and other specified losses were chargeable against the dealer's reserve account. When the amount in this account exceeded a specified minimum on agreed settlement dates, the finance company was obligated to pay such excess to the taxpayer. (*Hine Pontiac,* R. 26–28.)

The following amounts reflected in the dealer's reserve accounts at the end of the indicated years were not reported as income: 1953—$30,822.18; 1954—$58,154.69. The Commissioner determined deficiencies of $16,027.54 for 1953 and $26,381.47 for 1954 by including the aforementioned amounts in income in the respective years in which they were credited to the dealer's reserve account. (*Hine Pontiac,* R. 24, 28–29.) Hine Pontiac paid these deficiencies, plus interest of $5,581.91, and then filed claims for refund for the years 1953 and 1954; the claims were denied, and suit for refund followed. (*Hine Pontiac,* R. 25.) The District Court overruled the Commissioner's determination and entered judgment for Hine Pontiac in the principal amount of $42,409.01, plus interest. (*Hine Pontiac,* R. 87–89.) The Court of Appeals affirmed. (Appendix A, *infra,* pp. 9–10.)

Modern Olds, Inc.:

For the fiscal year ended March 31, 1954, Modern Olds was engaged in the business of selling automobiles. It sold cars on credit, receiving notes and chattel mortgages secured by a chattel mortgage lien for

the unpaid balance due on the purchase price, plus insurance premiums, interest and finance charges. Pursuant to a written contract with the Commercial Credit Corporation, a finance company, the taxpayer in the taxable year sold and transferred the greater portion of the notes to that company, endorsed without recourse. (*Modern Olds,* R. 17, 26–30, Ex. 2, R. 26–31, 37.)

On transfer and delivery of the notes, the finance company paid the taxpayer the unpaid balance of the cash selling price, but none of the interest or carrying charges which were included on the face of the note. At the time of such sale an additional amount was credited to the dealer's reserve account in taxpayer's name. Under its agreement with the finance company, the taxpayer was obligated to repurchase repossessed cars for the unpaid balance due on the notes, if repossessed within 90 days, or at the appraised value of the cars if repossessed at a later date. (*Modern Olds,* R. 18, 27–28.)

The finance company could charge against the reserve any indebtedness of the taxpayer to it, and was obligated to pay the taxpayer 3 times a year, if taxpayer was not then indebted to it, amounts by which the reserve exceeded 3% of the total balances outstanding on all notes purchased. The amount of $13,953.72, representing 3% of the customers' notes outstanding, was reflected in the dealer's reserve account at the end of the taxable year and was not reported as income, although the taxpayer is on the accrual basis. The Commissioner determined a deficiency of $4,186.11 by including the aforementioned

amount in income for the fiscal year ended March 31, 1954, the period in which the amount was credited to the dealer's reserve account. Modern Olds paid the deficiency, plus interest of $283.11, and then filed a claim for refund; the claim was disallowed, and this suit for refund followed. (*Modern Olds,* R. 14–16, 27.) The District Court overruled the Commissioner's determination and entered judgment for Modern Olds in the principal amount of $4,186.11, plus interest. (*Modern Olds,* R. 65–66.) The Court of Appeals affirmed. (Appendix A, *infra,* pp. 11–12.)

Charles M. Kilborn:

During the taxable years 1947–1949, a partnership of which Kilborn was a member, known as the Y Auto Sales, engaged in the business of selling used automobiles. The partnership sold cars on credit, receiving notes of purchasers for the balance due on the unpaid purchase price. Pursuant to written contract with the First National Bank of Mobile, the partnership sold and transferred the notes to that bank, with full recourse, and received the face amount of the notes, less the bank's discount, the amount required for recording the paper and the gross premiums on the insurance the bank was to take out. Of this purchase price, the bank paid or credited to the unrestricted use of the partnership the unpaid balance of the price for which the car was sold, less any financing charges or other charges imposed on the balance, or the National Automobile Dealers' Association's average loan value, whichever was lower. Any balance remaining of the purchase price of the notes was credited to a special reserve account in the name of

the partnership which by agreement was pledged by the partnership to the bank as collateral security for the payment by it of any sums which it might then or thereafter owe to the bank. (*Kilborn*, R. 26–34.)

Although it was on the accrual basis, the following amounts representing annual increments to the specific reserve account in the years indicated were not reported by the partnership as income: 1947—$3,837.29; 1948—$14,819.88; 1949—$1,691.43. The Commissioner determined deficiencies against the taxpayers by including the aforementioned amounts in income of the partnership for the respective years in which they were credited to the reserve account.[4] (*Kilborn*, R. 36, 159–175.) The Tax Court sustained the deficiencies. (*Kilborn*, R. 46.) The Court of Appeals reversed. (Appendix A, *infra*, pp. 13–14.)

REASONS FOR GRANTING THE WRIT

The question in these cases is the same as that presented in *Commissioner* v. *John R. Hansen and Shirley G. Hansen*, No. 380, this Term, and in *Commissioner* v. *Burl P. Glover*, No. 381, this Term, in which petitions for writs of certiorari were granted on November 10, 1958.

The agreements between the taxpayer automobile dealers and the financing companies with which they dealt are the same in all substantial respects as the agreement involved in the above cases. As in those cases, the decisions below are in direct conflict with

[4] The deficiencies on this and other issues, not here involved, aggregated $5,454.05, plus penalties of $1,209.43. (*Kilborn*, R. 46.)

decisions of the Sixth and Seventh Circuits.[5] See *Schaeffer* v. *Commissioner*, 258 F. 2d 861 (C. A. 6th), petition for rehearing pending; and *Baird* v. *Commissioner*, 256 F. 2d 918 (C. A. 7th), petition for certiorari pending, both of which are reprinted in Appendix C to the Commissioner's petition in *Hansen*. Writs having been granted in *Hansen* and *Glover*, this Court will soon have occasion to decide the issue involved in the instant cases. We therefore believe it appropriate, in order to protect the Government's interests, to file a petition in these cases. The Court may wish to hold this petition in abeyance pending disposition on the merits in Nos. 380 and 381.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

JOSEPH F. GOETTEN,
CAROLYN R. JUST,
Attorneys.

DECEMBER 1958.

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[5] As we noted in our petition in *Hansen*, the Tax Court has regularly sustained the Commissioner's position over a period of seventeen years. The Fourth and Fifth Circuits, as well as the Eighth and Ninth, have ruled to the contrary.

APPENDIX A

In the United States Court of Appeals for the Fifth Circuit

No. 17,242

UNITED STATES OF AMERICA, APPELLANT

v.

HINE PONTIAC, APPELLEE

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

Judgment

(Entered September 6, 1958)

Before HUTCHESON, JONES and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that one of the issues in this case is in certain respects the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* v. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* v. *Commissioner*; and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

Now therefore, it is ordered adjudged and decreed

that the decision of the District Court filed in this cause on December 18, 1957, is hereby affirmed in accordance with this Court's opinions in *Texas Trailercoach, Inc.* v. *Commissioner* and *West Pontiac, Inc.* v. *Commissioner.*

(S) JOHN MINOR WISDOM,
U. S. Circuit Judge—for the Court.

A true copy.
Test:

EDWARD W. WADSWORTH,
Clerk, U. S. Court of Appeals, Fifth Circuit.
By (S) GILBERT F. GANUSHEAN,
Deputy,
New Orleans, Louisiana.

Dated: September 6, 1958.
Consented to as to Form:

(S) Charles K. Rice,
CHARLES K. RICE,
Attorney for Appellant,

(S) L. W. Anderson,
L. W. ANDERSON,
1201 Corrigan Tower, Dallas 1, Texas,
Attorney for Appellee.

In the United States Court of Appeals for the Fifth Circuit

No. 17,245

UNITED STATES OF AMERICA, APPELLANT

v.

MODERN OLDS, INC., APPELLEE

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

Judgment

(Entered September 15, 1958)

Before HUTCHESON, Chief Judge, and JONES and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that one (1) issue in this case is essentially the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* vs. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* vs. *Commissioner;* and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

It further appearing that there are additional issues as to whether the amounts credited to a reserve account are income (1) irrespective of the specific provisions of the written reserve agreement between taxpayer and Commercial Credit Company (which issue is germane to the theory of the above cited decisions)

and (2) irrespective of the evidence in the record with respect to said amount of reserves being unaccrued and unpaid interest, which last issue it is unnecessary for this Court to reach at this time;

Now, therefore, it is ordered, adjudged and decreed that the Judgment of the District Court filed in this case on December 17, 1957, is hereby affirmed in accordance with this Court's opinions in *Texas Trailcoach, Inc.* vs. *Commissioner,* and *West Pontiac, Inc.* vs. *Commissioner.*

(S) JOHN MINOR WISDOM,
Judge.

Dated: September 15, 1958.

Consented to as to form:

(S) Charles K. Rice,
CHARLES K. RICE,
Attorney for Appellant,

(S) HERBERT S. BONNEY,
(Signed on carbon copy)
BONNEY, WADE AND STUBBLEFIELD,
Attorney for Appellee,
Dallas, Texas.

In the United States Court of Appeals for the Fifth Circuit

No. 17,226

CHARLES M. KILBORN AND ANGELINE W. KILBORN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Judgment

(Entered September 30, 1958)

Before RIVES, BROWN and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that the dealer reserve issue in this case is essentially the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* v. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* v. *Commissioner;* and it appearing that the double penalty issue in this case is essentially the same as that decided by this Court on July 23, 1958, in *Patchen* v. *Commissioner;* and

It further appearing that the parties to this proceeding desire to avoid expense in connection with this appeal; and that the respondent is willing without conceding the correctness of the petitioner's position on the dealer reserve issue, and that the petitioners are willing without conceding the correctness of the respondent's position on the double penalty issue, that these issues be disposed of without briefing and oral argument, and that all other issues raised on appeal be deemed to have been abandoned;

Now therefore, it is ordered, adjudged and decreed that the decision of the Tax Court entered in this cause on January 31, 1958—all issues raised on appeal other than the dealer reserve and double penalty issues having been abandoned—is hereby reversed insofar as the dealer reserve issue is concerned, in accordance with this Court's opinions in *Texas Trailercoach, Inc.* v. *Commissioner, West Pontiac, Inc.* v. *Commissioner,* and is, in all other respects, affirmed, in accordance with the Court's opinion in *Patchen* v. *Commissioner.*

(Signed) RICHARD T. RIVES,
Judge.

Dated: Sept. 29, 1958.

Consented to as to form:

(S) Vincent F. Kilborn
VINCENT F. KILBORN, Esquire
First National Bank Building, Mobile, Alabama
Attorney for Petitioners.

By: (S) VINCENT F. KILBORN
(S) Charles K. Rice
CHARLES K. RICE
Assistant Attorney General,
Attorney for Respondent.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

Rev. Rul. 57-2, 1957-1 Cum. Bull. 17:

Amounts withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income to dealers employing the accrual method of accounting, to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer, regardless of whether charges for worthless notes are also made to the account pursuant to an agreement between the parties. Losses sustained on worthless notes shall be separately established by the dealer as required by section 166 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state its position with respect to the treatment, for Federal income tax purposes, of amounts withheld by banks and finance companies to cover possible losses on notes purchased from automobile or other dealers employing the accrual method of accounting, and which are recorded on the books of the bank or finance company as a liability of the bank or finance company to the dealer.

The steps generally involved in transactions concerning automobile dealers are as follows: When a car is purchased on credit from a dealer, the purchaser makes a down-payment,

either in the form of cash or by turning in another car at an agreed value, the balance being satisfied by the purchaser's promissory note and a supporting conditional sales contract. The face amount of the note reflects two elements—the balance of what would be the purchase price of the car, if bought for cash, and a finance charge. As between the purchaser and the dealer, the transaction is closed and completed at this point with the attendant tax consequences to the dealer.

It is then common practice for the dealer to sell or discount the purchaser's note and sales contract to some financial institution. The finance company or bank acquires the note at a value somewhat less than its face value, the difference representing a charge for its service. Simultaneously, either cash or unrestricted credit is given to the dealer to the extent of the amount reflected in the face value of the note that corresponds to the unpaid balance of the cash retail price of the car. The difference between the face value of the note and the sum of the finance company's charge and its credit or immediate payment to the dealer (representing part of the finance charge previously mentioned) is then credited on the books of the finance company as a liability of the finance company to the dealer. The accumulation of these credits is generally known as a "dealers reserve" and is the specific object of the present consideration.

Settlement of the liability represented by the reserve is subject to agreement between the particular dealer and the financial institution involved. In some instances, the agreement does not contemplate the charging of any items against the reserve account, while in others the account reflects a running record of various transactions between the parties, that is, both credits and charges are entered, depending upon the nature of the item. Thus, in certain in-

stances, the dealer and the finance company may agree that notes purchased or discounted are to be charged to the reserve account in the event they become worthless.

With regard to those instances where losses incurred by a finance company on notes purchased from automobile dealers may not be charged against the reserve, the credits to the reserve, by the finance company in favor of a dealer who employs the accrual method of accounting constitute income to the dealer at the time such credit is made, even though the dealer is not immediately or even currently able to draw on the entire reserve. See G. C. M. 9571, C. B. X–2, 153 (1931), and *Shoemaker-Nash, Inc.* v. *Commissioner,* 41 B. T. A. 417. The principles involved in the purchase of notes from automobile dealers by banks or finance companies as described above are equally applicable where notes are purchased, under similar conditions, from dealers in items other than automobiles.

Where a dealer's reserve is in the nature of a running account, the charging thereto of worthless notes pursuant to agreement between the parties has no bearing upon the fact that taxable income has been received by the dealer, or upon the time of its realization as otherwise evidenced by the credits to such reserve.

Accordingly, it is held that credits to such reserve, in the case of a dealer employing the accrual method of accounting, constitute income to the dealer at the time such credits are made regardless of whether charges to the account for worthless notes are also made pursuant to an agreement between the parties. Losses sustained on worthless notes are to be separately established by the dealer as required by the provisions of section 166 of the Internal Revenue Code of 1954 relating to bad debts.

In arriving at these conclusions, consideration has been given the case of *Blaine Johnson et al.* v. *United States,* 233 Fed. (2d) 952. See also, *Albert M. Brodsky et ux.* v. *Commissioner,* 27 T. C. No. 23.

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